ACCOUNTING
Chapter 10: Liabilities/Special Liabilities

▪ CURRENT LIABILITIES

Obligations that must be paid within _________ year or within the operating cycle, whichever is longer, are called ***current liabilities.*** Another requirement for classification as a *current liability* is that the debt will be paid from ***current*** _____________.

Obligations that will not be paid within one year or one operating cycle are called _____________ liabilities.

Among the most common examples of *current liabilities* are:
- o accounts _____________
- o ____________-term notes payable (bank loan)
- o the ________________ portion of long-term debt
- o accrued liabilities (interest payable, income taxes payable, payroll liabilities, and *unearned* _________________

Short-term note payable: On Nov. 1 Porter Company borrows $10,000 from its bank for a period of six months at an annual interest rate of 12%. Six months later on May 1 Porter Co. pays the bank the principal amount of $10,000 plus $________interest.

Interest Payable
- **Interest ____________________ is the compensation to the lender for giving up the use of money for a period of time.**
- **The liability is called interest ___________________.**
- **To the lender, interest is ____________________.**
- **To the borrower, interest is an ___________________.**

How to determine interest on the 6-month note payable above

I = P x R x T
I = 10,000 x .12 x ½ (6 months)
I = ____________ x ½

I = $__________

The journal entry to record *the borrowing of $10,000* from the bank would be:

(debit) ________________ 10,000
(credit) ____________________ 10,000

The journal entry at December 31 *to record interest expense that has accrued* for 2 months would be:

(debit) ______________________ .... __________
(credit) ______________________ ...... __________

Payroll

GROSS PAY ⟶ NET PAY

What are some typical deductions taken out of your paycheck?

-
-
-
-
-

Every employer must compute, record and pay a number of other costs in addition to the wages and salaries. The following example shows the *costs* incurred in a typical monthly payroll:

Gross Pay (wages expense)	$100,000
Social Security and Medicare taxes	7,650
Federal & State unemployment taxes	6,200
Workers' compensation insurance premiums	4,000
Group health insurance premiums	10,500
Employee pension plan contributions	5,000

*Costs shown in *italics* are payroll taxes & insurance premiums required by law

All employers *must* pay ____________________ **and** _________________ **taxes** on the wages or salary paid to each employee. These taxes currently amount to 7.65% of the employee's earnings. (employers must match Social security and Medicare taxes paid by the employee)

Federal _____________________ **taxes** apply only to the first $7,000 earned by each employee during the year (state unemployment taxes may vary)

Workers' _______________________ is a state mandated program that provides insurance to employees against ___________-related injury. Premiums vary greatly by state and by occupational classification. In some high-risk industries (e.g., roofers), workers' compensation premiums may exceed 50% of the employee's wages.

Many employers pay some or all of the costs of ___________ **insurance** for their employees as well as make contributions to **employee** _____________ **plans.**

▪ LONG-TERM LIABILITIES

Long-term obligations usually arise from *major* expenditures, such as acquisitions of plant assets, the purchase of another company, or refinancing an existing long-term obligation that is about to mature. Thus transactions involving long-term liabilities are relatively few in number but often involve large dollar amounts.

In contrast, current liabilities usually arise from routine operating transactions.

Examples of *long-term liabilities* are:

- installment notes payable
- bonds payable
- mortgage payable
- unfunded liability for nonpension postretirement benefits

Allocating installment payments between interest and principal:

In accounting for an installment note, the accountant must determine the portion of each payment that represents interest expense and the portion that reduces the principal amount of the liability. This distinction is made in advance by preparing an ____________________ table. (See page 4)

An *amortization table* begins with the original amount of the liability ($16,398) listed at the top of the **Unpaid Balance column**. The amounts of the monthly payments, shown in **Column A**, are specified by the installment contract. The monthly interest expense, shown in **Column B**, is computed for each month by applying the *monthly interest rate* to the unpaid balance at the *beginning of that month.*

The portion of each payment that reduces the amount of the liability **(Column C)** is simply the remainder of the payment **(Column A minus Column B).** Finally, the unpaid balance of the liability **(Column D)** is reduced each month by the amount indicated in **Column C.**

AMORTIZATION TABLE
(12% Note Payable for $16,398; Payable in 18 Monthly Installments of $1,000)

Interest Period	Payment Date	(A) Monthly Payment	(B) Interest Expense (1% of the Last Unpaid Balance)	(C) Reduction in Unpaid Balance (A) – (B)	(D) Unpaid Balance
Issue date	Oct. 15, Year 1	—	—	—	$16,398
1	Nov. 15	$1,000	$164	$836	15,562
2	Dec. 15	1,000	156	844	14,718
3	Jan. 15, Year 2	1,000	147	853	13,865
4	Feb. 15	1,000	139	861	13,004
5	Mar. 15	1,000	130	870	12,134
6	Apr. 15	1,000	121	879	11,255
7	May 15	1,000	113	887	10,368
8	June 15	1,000	104	896	9,472
9	July 15	1,000	95	905	8,567
10	Aug. 15	1,000	86	914	7,653
11	Sept. 15	1,000	77	923	6,730
12	Oct. 15	1,000	67	933	5,797
13	Nov. 15	1,000	58	942	4,855
14	Dec. 15	1,000	49	951	3,904
15	Jan. 15, Year 3	1,000	39	961	2,943
16	Feb. 15	1,000	29	971	1,972
17	Mar. 15	1,000	20	980	992
18	Apr. 15	1,000	8*	992	-0-

*In the last period, interest expense is equal to the amount of the final payment minus the remaining unpaid balance. This compensates for the cumulative effect of rounding interest amounts to the nearest dollar.

Work Page

ACCOUNTING
Liabilities—Notes Payable

Paxton Corp. borrowed $30,000 at a rate of 10%. The note was dated June 1, 2004 and came due on February 1, 2005.

1. What was the **annual** amount of interest on the note?
   $______________year

2. What was the amount of interest that Paxton actually paid to borrow the $30,000?
   $______________

3. Show the journal transaction that would have been recorded on June 1, 2004:

GENERAL JOURNAL

4. Show the journal transaction that would have been recorded on June 30 to record accrued interest:

GENERAL JOURNAL

5. Show the journal transaction that would have been recorded on February 1, 2005 the note was paid.

GENERAL JOURNAL

6. How much interest expense would have been recorded in 2004 on this note?
   $______________

7. How much interest expense would have been recorded in 2005 on this note?
   $______________

N/P Problems:

On November 1, 2012, Nathan Associates borrowed $400,000 from Katie's Credit Union and signed a 14%, one year note payable, all due at maturity. (Round to the nearest dollar)

a) The amount Nathan must pay on November 1, 2013 when the note matures is
$ ____________________

b) The Interest expense Nathan will recognize on this note on December 31, 2012 is
$ ____________________

On August 1, 2012, Foster Partners borrowed $200,000 from Smith Credit Union and signed a 8%, one year note payable, all due at maturity. (Round to the nearest dollar)

a) The amount Foster must pay on August 1, 2013 when the note matures is
$ ____________________

b) The Interest expense Foster will recognize on this note on December 31, 2012 is
$ ____________________

On March 1, 2012, Sam Associates borrowed $1,800,000 from Cody Credit Union and signed a 3%, one year note payable, all due at maturity. (Round to the nearest dollar)

a) The amount Sienna must pay on March 1, 2013 when the note matures is
$ ____________________

b) The Interest expense Sienna will recognize on this note on December 31, 2012 is
$ ____________________

ACCOUNTING
Notes Payable Quiz

During the fiscal year ended December 31, 2012, Keenan Inc. carried out the following transactions involving notes payable.

- **Prepare journal entries using the general journal form provided**
- **Use a 360-day year in making interest calculations**
- **Prepare the adjusting entry needed at December 31 to accrue interest owed on notes payable. (Assume adjusting entries are annually) Use one entry for both notes**

Aug 6	**Borrowed $16,000 from Wyoming Bank, issuing a 45-day, 12% note payable.**
Sept. 16	**Purchased office equipment from Office Decor. The invoice amount was $20,000, and Office Décor agreed to accept as full payment a 12%, 3-month note for the invoice amount.**
Sept. 20	**Paid the Wyoming Bank note plus accrued interest.**
Nov. 1	**Borrowed $240,000 from First Trust Bank at an interest rate of 12%; signed a 90-day note.**
Dec. 1	**Purchased merchandise (to resell) in the amount of $4,000 from P. J. Mosher. Mosher accepted a 90-day note bearing interest at 14%.**
Dec. 16	**The $20,000 note payable to Office Décor matured today. Paid the note and interest accrued.**
Dec. 31	**Prepare the adjusting entry needed at December 31 to accrue interest owed on notes payable.**

General Journal

Date		Account Titles	Ref.	Debit		Credit	

ACCOUNTING
Notes Payable

During the fiscal year ended December 31, 2010, Lasser Lollipop's Incorporated carried out the following transactions involving notes payable.

- **Prepare journal entries using the general journal form provided**
- **Use a 360-day year in making interest calculations**
- **Prepare the adjusting entry needed at December 31 to accrue interest owed on notes payable. (Assume adjusting entries are annually) Use one entry for both notes**

Aug 6	**Borrowed $12,000 from Barb Bank, issuing a 45-day, 12% note payable.**
Sept. 16	**Purchased office equipment from House Decor. The invoice amount was $30,000, and House Décor agreed to accept as full payment a 12%, 3-month note for the invoice amount.**
Sept. 20	**Paid the Barb Bank note plus accrued interest.**
Nov. 1	**Borrowed $200,000 from Ramy Trust Bank at an interest rate of 12%; signed a 90-day note.**
Dec. 1	**Purchased merchandise (to resell) in the amount of $6,000 from Lowe Associates. Lowe accepted a 90-day note bearing interest at 14%.**
Dec. 16	**The $30,000 note payable to House Décor matured today. Paid the note and interest accrued.**
Dec. 31	**Prepare the adjusting entry needed at December 31 to accrue interest owed on notes payable.**

General Journal

Date		Account Titles	Ref.	Debit		Credit	

ACCOUNTING
Notes Payable

During the fiscal year ended December 31, 2010, GW Co. carried out the following transactions involving notes payable.

- Prepare journal entries using the general journal form provided
- Use a 360-day year in making interest calculations
- Prepare the adjusting entry needed at December 31 to accrue interest owed on notes payable. (Assume adjusting entries are annually) Use one entry for both notes

Aug 6	Borrowed $10,000 from Grace Loans, issuing a 45-day, 10% note payable.
Sept. 16	Purchased office equipment from Flowers Furniture. The invoice amount was $20,000, and Flowers Furniture agreed to accept as full payment a 14%, 3-month note for the invoice amount.
Sept. 20	Paid the Grace Loans note plus accrued interest.
Nov. 1	Borrowed $225,000 from Sylvester Trust Bank at an interest rate of 12%; signed a 90-day note.
Dec. 1	Purchased merchandise (to resell) in the amount of $8,000 from Abbott Associates. Abbott Associates accepted a 90-day note bearing interest at 8%.
Dec. 16	The $20,000 note payable to Flowers Furniture matured today. Paid the note and interest accrued.
Dec. 31	Prepare the adjusting entry needed at December 31 to accrue interest owed on notes payable.

General Journal

Date		Account Titles	Ref.	Debit		Credit	

ACCOUNTING
Notes Payable

During the fiscal year ended December 31, 2011, Dunleer Corporation carried out the following transactions involving notes payable.

- Prepare journal entries using the general journal form provided
- Use a 360-day year in making interest calculations
- Prepare the adjusting entry needed at December 31 to accrue interest owed on notes payable. (Assume adjusting entries are made *annually)* Use one entry for both notes

Aug 6	Borrowed \$11,200 from Tom Hutchins, issuing him a 45-day, 12% note payable.
Sept. 16	Purchased office equipment from Harper Company. The invoice amount was \$16,800 and Harper Company agreed to accept as full payment a 12%, 3-month note for the invoice amount.
Sept. 20	Paid the Hutchins note plus accrued interest.
Nov. 1	Borrowed \$235,000 from Sun National Bank at an interest rate of 12%; signed a 90-day note payable.
Dec. 1	Purchased merchandise (to resell) in the amount of \$3,000 from Kramer Co. Kramer Co. accepted a 90-day note bearing interest at 14%.
Dec. 16	The \$16,800 note payable to Harper Company matured today. Paid the note payable and interest accrued.

	General Journal		

ACCOUNTING FOR PAYROLL
Journal Entries

Litchfield Corporation's payroll records for the payroll period ending Jan. 15 showed **gross earnings of $630,000** and **income tax withholding of $145,000.** The payroll was subject to a **social security tax rate of 6%** on a $90,000 base, to a **medicare tax rate of 1.5%** on all wages, to **state unemployment tax of 5.4%** on a $7,000 base, and to **federal unemployment tax of 0.8%** on a $7,000 base. No employee earned more than $7,000 during this period.

Prepare two separate journal entries below to record

a) the accrued payroll and deductions from employees' pay
b) the payroll taxes on the employer resulting from this payroll

GENERAL JOURNAL

a)

GENERAL JOURNAL

b)

ACCOUNTING FOR PAYROLL
Payroll Journal Entries

Larchmont Corporation's payroll records for the payroll period ending Jan. 15 showed **gross earnings of $450,000** and **income tax withholding of $165,000.** The payroll was subject to a **Social Security tax rate of 6.2%** on a $102,000 base, to a **Medicare tax rate of 1.45%** on all wages, to **state unemployment tax of 5.4%** and to **federal unemployment tax of 0.8%.**
*No employee earned more than $102,000 during this period.

Prepare two separate journal entries below to record

a) the accrued payroll and deductions from employees' pay
b) the payroll taxes on the employer resulting from this payroll

GENERAL JOURNAL

a)

GENERAL JOURNAL

b)

ACCOUNTING FOR PAYROLL
Payroll Journal Entries

Extreme Enterprise's payroll records for the payroll period ending Jan. 15 showed **gross earnings of $950,000** and **income tax withholding of $108,000.** The payroll was subject to a **Social Security tax rate of 6.2%** on a $102,000 base, to a **Medicare tax rate of 1.45%** on all wages, to **state unemployment tax of 5.4%** and to **federal unemployment tax of 0.8%.**
*No employee earned more than $102,000 during this period.

Prepare two separate journal entries below to record

a) the accrued payroll and deductions from employees' pay
b) the payroll taxes on the employer resulting from this payroll

GENERAL JOURNAL

a)

GENERAL JOURNAL

b)

ACCOUNTING FOR PAYROLL
Payroll Journal Entries—make-up

Visual Horizon's payroll records for the payroll period ending Jan. 15 showed **gross earnings of $750,000** and **income tax withholding of $88,000.** The payroll was subject to a **Social Security tax rate of 6.2%** on a $102,000 base, to a **Medicare tax rate of 1.45%** on all wages, to **state unemployment tax of 5.4%** and to **federal unemployment tax of 0.8%.**

*No employee earned more than $102,000 during this period.

Prepare two separate journal entries below to record

a) the accrued payroll and deductions from employees' pay
b) the payroll taxes on the employer resulting from this payroll

GENERAL JOURNAL

a)

GENERAL JOURNAL

b)

ACCOUNTING FOR PAYROLL
Journal Entries

Kaupp Corporation's payroll records for the payroll period ending Jan. 15 showed **gross earnings of $535,000** and **income tax withholding of $115,000.** The payroll was subject to a **social security tax rate of 6%** on a $90,000 base, to a **medicare tax rate of 1.5%** on all wages, to **state unemployment tax of 5.4%** on a $7,000 base, and to **federal unemployment tax of 0.8%** on a $7,000 base. No employee earned more than $7,000 during this period.

Prepare two separate journal entries below to record

a) the accrued payroll and deductions from employees' pay
b) the payroll taxes on the employer resulting from this payroll

GENERAL JOURNAL

a)

GENERAL JOURNAL

b)

Work Page

ACCOUNTING
Notes Payable Quiz

During the fiscal year ended December 31, 2011, Bolton Corporation carried out the following transactions involving notes payable.

- **Prepare journal entries using the general journal form provided**
- **Use a 360-day year in making interest calculations**
- **Prepare the adjusting entry needed at December 31 to accrue interest owed on notes payable. (Assume adjusting entries are made *annually)* Use one entry for both notes**

Aug 6	**Borrowed $14,000 from Hudson Bank, issuing a 45-day, 12% note payable.**
Sept. 16	**Purchased office equipment from Hampton Company. The invoice amount was $18,000 and Hampton Company agreed to accept as full payment a 12%, 3-month note for the invoice amount.**
Sept. 20	**Paid the Hudson Bank note plus accrued interest.**
Nov. 1	**Borrowed $235,000 from First National Bank at an interest rate of 12%; signed a 90-day note payable.**
Dec. 1	**Purchased merchandise (to resell) in the amount of $3,000 from J. Krummer. Krummer accepted a 90-day note bearing interest at 14%.**
Dec. 16	**The $18,000 note payable to Hampton Company matured today. Paid the note payable and interest accrued.**
Dec. 31	**Prepare the adjusting entry needed at December 31 to accrue interest owed on notes payable.**

General Journal